



STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

JENNIFER M. GRANHOLM
GOVERNOR

ROBERT J. KLEINE
STATE TREASURER

DATE: April 22, 2009
TO: Jennifer M. Granholm, Governor
FROM: Robert J. Kleine, State Treasurer *RJK*
SUBJECT: Preliminary Review of the City of Ecorse

I. Background

On March 17, 2009, pursuant to a request by the Ecorse Board of Education, the Department of Treasury commenced a preliminary review of the finances of the City of Ecorse to determine whether or not a serious financial problem existed. Section 12(1) of Public Act 72 of 1990, the Local Government Fiscal Responsibility Act, requires that a preliminary review be conducted if one or more of the conditions enumerated therein occurs. The preliminary review of the City of Ecorse resulted from the conditions enumerated in subdivision (m) of Section 12(1) having occurred within the City.¹

During the week of March 17, 2009, Treasury staff met with various City officials, including Erwin L. Hollenquest, the City's Controller; Rhonda Major, the City's Deputy Treasurer; and representatives from the City's current auditing firm of Martin, Arrington, Desai, & Meyers, P.C.

As summarized below, based upon information received and considered as part of the preliminary review -- including the recurring inability of the City to distribute property taxes timely, an improper reliance upon interfund borrowing from restricted revenues to cover operating expenses, the inability of City officials to file financial audit reports timely, recurrent accumulated deficit spending, and unresolved material, internal control deficiencies -- I conclude that a serious financial problem does exist in the City of Ecorse and recommend appointment of a financial review team. Appointment of a financial review team is a prerequisite step in the Act 72 process to the appointment of an emergency financial manager.

II. Preliminary Review Findings

The preliminary review found the following:

- For the 12-month period from March 2008 to February 2009, the City received over \$17 million in property tax collections. During a typical year, City collections for its own operations are

¹ Subdivision (m) provides that "[t]he local government is delinquent in the distribution of tax revenues, as required by law, that it has collected for another taxing jurisdiction, and that taxing jurisdiction requests a preliminary review".

approximately \$7 million. However, during the 12-month period in question, the City transferred approximately \$9.6 million to its general fund and payroll account. In effect, the City borrowed \$2.6 million, which it had collected on behalf of other taxing units of government, and used that amount to fund its own operations. This borrowing resulted in an untimely disbursement of those taxes by the City to the other taxing units of government in violation of Public Act 206 of 1893, the General Property Tax Act.

For example, during July 2008, it is estimated that the City collected over \$1.6 million in property taxes for the Ecorse School District. However, a payment of only \$1,250,000 was made by the City to the School District on August 14, 2008. Similarly, during August 2008, it is estimated that the City collected more than \$1 million in property taxes for the School District. However, the preliminary review found no evidence of any disbursements to the School District until October 1, 2008, and then only in the amount of \$500,000.

- The City faces significant cash-flow shortages, reflected by negative cash balances in various funds, and transfers to the general fund from the current tax collection fund and from other restricted funds such as the major street fund and local street fund. These transfers represent unauthorized interfund borrowing resulting in fewer resources for the funds from which monies were borrowed. Because the City has not yet filed a financial audit for its most recently completed fiscal year, the preliminary review was unable to determine the precise amount of any interfund borrowing for the period July 1, 2007 through June 30, 2008. However during the City's 2007 fiscal year, for example, its general fund borrowed \$333,132 and \$231,538 from the major street fund and the local street fund, respectively.
- For the last six fiscal years, the City has not filed timely annual audit reports with the Department of Treasury as required by Public Act 2 of 1968, the Uniform Budgeting and Accounting Act:

<u>Fiscal Year Ending</u>	<u>Due date</u>	<u>Date Filed</u>
June 30, 2003	December 31, 2003	February 24, 2004
June 30, 2004	December 31, 2004	March 31, 2005
June 30, 2005	December 31, 2005	April 12, 2006
June 30, 2006	December 31, 2006	November 19, 2007
June 30, 2007	December 31, 2007	September 11, 2008
June 30, 2008	December 31, 2008	Not Yet Filed

- Annual general fund expenditures of the City have consistently exceeded general fund revenues, resulting in accumulated deficits. See Attachment 1. Deficit elimination plans required by Public Act 140 of 1971, the Glenn Steil State Revenue Sharing Act of 1971, have not eliminated the deficits. No deficit elimination plan was filed for 2006. The City did file a deficit elimination plan on October 25, 2008, for the fiscal year ending June 30, 2007. However, the Department of Treasury

did not certify the plan because it did not provide adequate assurances that the deficits would be eliminated. As reflected in Attachment 1, the City's general fund has consistently operated in a deficit condition since at least 2004. (The \$1,495,441 operating surplus for the 2004 fiscal year is an aberration; it reflects a one-time, \$2.4 million litigation-related payment from a corporate taxpayer, but for the receipt of which there would have been an operating deficit.) In regards to deficits in City funds other than the general fund, the City appears to be making progress in their reduction and eventual elimination.

- For several years, the City has had recurring internal control deficiencies in regards to its financial operations. The City's audit firm noted in the 2007 fiscal year audit that "[i]n auditing the financial statements for the year ended June 30, 2007, we encountered some of the same deficiencies as referred to in our management letters related to the audits for the years ended June 30, 2006 and June 30, 2005. Some of the following comments have also been noted in prior auditors management letters related to the audits for the years ended June 30, 2004 and 2003." The audit firm also indicated the following:

We noted that the City has virtually no formal internal controls and review processes that have been designed, documented, adopted, implemented, reviewed, and maintained. As a result, the City is consistently not prepared for its annual audit and is often not in a position to adequately assess and correct or update its own accounting operations and transactions in a timely and complete manner. These include such areas as internal analytical review of all of its own transactions monthly, ability to prepare accurate and timely balances which the City can compare against budgets to know where the City stands financially on a monthly basis and not have to wait until after the annual external audit is complete to actually be sure, perform monthly close-outs of the accounting books and records, preparing monthly complete financial statements for council review, etc.

There is no evidence to suggest that City officials have resolved the ongoing issues of internal controls deficiencies during the 2008 fiscal year (for which an audit has not yet been filed), or for the current fiscal year. These recurring issues include, but are not limited to: the lack of a capital assets schedule, recurring deficit spending, component units not being presented, bank reconciliations not being performed timely, the general ledger not being reviewed for accuracy, and incorrect general ledger entries needing material audit adjustments.

Attachments

cc: Valdemar L. Washington, Deputy State Treasurer
Frederick Headen, Director, Bureau of Local Government Services

Attachment 1

	2004	2005	2006	Adverse ¹ 2007	Preliminary ² 2008
Beginning Fund Balance	\$ 4,142,509	\$ 5,413,583	\$ 1,237,893	\$ (3,952,508)	\$ (5,867,853)
Revenues	11,752,947	11,866,986	10,554,750	10,765,419	11,369,478
National (U.S.) Steel Tax Suit Settlement	2,494,633				
Expenditures	(12,752,139)	(14,678,832)	(14,411,937)	(13,164,211)	(15,924,414)
Revenues Over (Under) Expenditures - Operating	1,495,441	(2,811,846)	(3,857,187)	(2,398,792)	(4,554,936)
Other Financing Sources (Uses)					
Police/Fire Pension Judgement		(1,100,000)	(1,100,000)		³ (1,100,000)
Transfer In	85,853	61,582	60,844		
Transfer Out	(462,468)	(474,559)	(447,530)	(454,553)	(451,431)
Transfer In for administration of Water and Sewer	152,248	149,133	153,472	938,000	⁴
Total Other Financing Sources (Uses)	(224,367)	(1,363,844)	(1,333,214)	483,447	(1,551,431)
Ending Fund Balance	\$ 5,413,583	\$ 1,237,893	\$ (3,952,508)	\$ (5,867,853)	\$ (11,974,220)

1. An adverse opinion states that the financial statements do not present fairly the financial position or the results of operations or cash flows in conformity with generally accepted accounting principles. Such an opinion is expressed when, in the auditor's judgment, the financial statements taken as a whole are not presented fairly in conformity with generally accepted accounting principles. (American Institute of Certified Public Accountants, Statements on Auditing Standards, section AU 508.58)
2. Preliminary actual numbers were used because final audited numbers for the fiscal year ending June 30, 2008 were not available at the time of this review. Final audited numbers will vary from those used in this report.
3. This amount will be adjusted out to the various departments in the general fund. These adjustments to other departments will have no effect on the ending fund balance. We were informed that it will merely be booked to different department line items within the general fund rather than the police/fire pension transfer out line item.
4. The minimum \$400,000 charge to the Water and Sewer is booked at the end of the year prior to the completion of the audit. It will increase the fund balance of the general fund by charging the water and sewer fund for overhead costs.